



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS
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DIVISION OF ENERGY RESOURCES

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August 8, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications & Energy
One South Station, Second Floor
Boston, Massachusetts 02110

Re: Bay State, D.T.E. 05-27: Record Requests

Dear Ms. Cottrell:

On behalf of the Massachusetts Division of Energy Resources, please find attached the responses to the following Record Requests of the Department of Telecommunications and Energy (DTE):

RR-DTE-119

RR-DTE-120

RR-DTE-121

Thank you for your attention to this matter.

Sincerely,

Steven I. Venezia
Deputy General Counsel

Cc: Caroline Bulger, Hearing Officer (2 copies)
Paul E. Osborne, Asst. Director – Rates and Revenue Requirements Div. (1 copy)
Andreas Thanos, Asst. Director, Gas Division (1 copy)
A. John Sullivan, Rates and Revenue Requirements Division (2)
Service List (1 electronic copy)

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

RESPONSE OF DIVISION OF ENERGY RESOURCES TO RECORD REQUESTS
FROM THE DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Date: August 8, 2005

Responsible: Alvaro E. Pereira, Manager of Energy Supply and Pricing, DOER

RR-DTE-119 Refer to the direct testimony of Dr. Pereira, at 7. According to Dr. Pereira, Bay State's O&M costs should be under the PCI plan while the non-O&M costs should be under a price freeze. Please discuss the extent to which this proposal will spur the potential benefits associated with incentive regulation as envisioned in DTE 94-158, in the same way as the Company's proposal.

Response: Dr. Kaufmann's response to DTE-4-42 reviews the benefits associated with incentive regulation that were delineated in DTE 94-158, relative to cost of service regulation. A price freeze will provide similar benefits to those described in this response because it is a form of incentive regulation. Indeed, Dr. Kaufmann's testimony (Exhibit BSG/LRK-1, p.11, lines 23-26, makes this point. First, Bay State's non-O&M costs are not linked to its own costs, but rather to a fixed, price level. As described in the response to DTE-DOER-1-9, there has been no evidence that Bay State has performed better than the industry in terms of non-O&M costs, unlike its performance with its O&M costs. A price freeze will provide incentives to Bay State to improve its performance relative to the industry.

Another benefit to incentive regulation is lower regulatory costs. Implementing a price freeze for part of Bay State's costs will not incur any additional regulatory costs relative to Bay State's proposal. On the other hand, a price freeze, by definition, reduces price uncertainty and volatility to ratepayers.

Finally, a price freeze is no different than the Company's proposed PCI plan in allowing the Company to retain, depending on the particulars of any earnings sharing mechanism, a portion of its cost improvements. This freedom to retain earnings advances innovation and dynamic efficiency.

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Date: August 8, 2005

Responsible: Alvaro E. Pereira, Manager of Energy Supply and Pricing, DOER

RR-DTE-120 In the Company's response to DTE-4-42, at 6, Bay State stated that the proposed PBR creates equally strong incentives to control costs as the expired rate freeze to satisfy the Department's objectives of more efficient pricing and elimination of cross-subsidies. In light of the Company's statement, please explain how DOER's proposal allows for pricing flexibility and the elimination of cross-subsidization between rate classes.

Response: The basis of the Company's statement in this response is not clear. Issues of cross-subsidization are addressed in the establishment of the base rate elements. Both the proposed PBR and Dr. Pereira's suggested revisions to the PBR would be applied after the base rate elements have been established. In other words, the cost allocation by rate class will already have been set. Further, under section 7.2 of Rate Schedule MDTE 63, page 8 of 19, the allocation of the revenue increase allowed under the PBR would be limited within the rate classes. Therefore, to the extent there are any cross subsidies, they will remain even with the application of the PBR.

In terms of pricing flexibility, it is true that freezing a portion of the Company's prices will reduce pricing flexibility that is available to the Company, but the benefits of the freeze in terms of providing incentives to control non-O&M costs outweigh potential benefits from additional pricing flexibility.

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Date: August 8, 2005

Responsible: Alvaro E. Pereira, Manager of Energy Supply and Pricing, DOER

RR-DTE-121 Refer to the direct testimony of Dr. Pereira, at 7. According to Dr. Pereira, there is no evidence to indicate that the Company's price freeze of the past few years had any impacts on reducing non-O&M costs. In view of this, Dr. Pereira has proposed an alternative PCI formula to be applied to O&M costs only, with non-O&M costs subject to a price freeze. Please explain why Dr. Pereira believes that a rate freeze to be applied to capital and other non O&M costs will have any impact on reducing non-O&M costs.

Response: The Company's experience with a price freeze indicates that the price freeze motivated cost reductions in O&M costs. Under the assumption that superior cost performers have fewer opportunities to further reduce their costs than average cost performers, it follows that application of a rate freeze for non-O&M costs should enable reductions in the cost category that did not feature superior cost performance.

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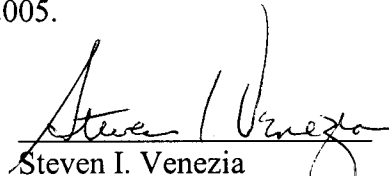
Bay State Gas Company

D.T.E. 05-27

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing copy of the Massachusetts Division of Energy Resources' Response to the Record Requests in D.T.E. 05-27 to be delivered in hand to the Department of Telecommunications & Energy; and to be served by electronic mail to all parties whose names and addresses appear on the service list in accordance with the requirements of 220 CMR 1.05 of the Department's Rules of Practice and Procedure.

Dated at Boston this eighth day of August 2005.


Steven I. Venezia
Deputy General Counsel

For:

Commonwealth of Massachusetts
Division of Energy Resources
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